COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, SEPTEMBER 27, 2002

APPLICATION OF

VIRGINIA NATURAL GAS, INC.

CASE NO. PUE-2002-00237

For approval of a Weather Normalization Adjustment Rider

ORDER APPROVING EXPERIMENT

On April 16, 2002, pursuant to § 56-40 of the Code of Virginia ("Code") and 5 VAC 5-20-80 of the Rules of Practice and Procedure of the State Corporation Commission ("Commission"), Virginia Natural Gas, Inc. ("VNG" or "Company") filed with the Commission an application for approval of a Weather Normalization Adjustment ("WNA") Rider applicable to Schedule 1 – Residential Firm Gas Sales Service and Schedule 2 – General Firm Gas Sales Service of the Company's rate schedules.

By orders dated April 29 and 30, 2002, the Commission prescribed notice and invited comments and/or requests for hearing in this case. Comments from interested persons were filed on or before June 12, 2002. Commission Staff ("Staff") filed its report on July 31, 2002 ("Staff Report"). No party requested a hearing.

On August 13, 2002, VNG filed a response to the Staff Report ("Response"). The Response includes an Offer of Settlement from the Company and the Office of the Attorney General, Division of Consumer Counsel ("Consumer Counsel"). VNG explains that settlement discussions have been ongoing among the Staff, the Company, and Consumer Counsel, and that the Company and Consumer Counsel have reached an agreement that is memorialized in the Offer of Settlement.

In its Response, VNG states that under the Offer of Settlement, among other things: (1) the WNA would be implemented as an experimental rate design pursuant to § 56-234 of the Code; (2) the experimental rate design would terminate in two years from the date of approval thereof, subject to Commission action either extending or making such rate design permanent provided, however, that any request by the Company for such extension or permanent rate must be accompanied by a fully adjusted cost of service study and the schedules required for a general rate case; (3) the WNA would be calculated on a real-time basis so that each monthly bill will be affected only by the weather experienced during the preceding month; (4) the WNA would be modified to track actual weather and to potentially modify six monthly bills, rather than twelve, each year; (5) the Company commits to develop a bill format and consumer education program in a form

acceptable to Staff that will inform customers of the need for, and the mechanics of operation of, the WNA program; (6) VNG's allowed return on common equity would be modified from the current range of 10.4 - 11.4 percent, to 10.0 – 11.8 percent for purposes of future Annual Informational Filings ("AIFs"), with 10.0 percent being used to determine the write-off of deferred expenses; (7) any change in the authorized return on equity, or an attempt to measure the impact of the WNA on risk and return, would be considered in the context of a general rate case; and (8) VNG commits not to file a base rate case, or any non-gas revenue neutral rate design proposals applicable to residential and general service rate classes, before July 1, 2004, except under emergency conditions as set forth in § 56-245 of the Code.

On August 15, 2002, the Commission issued an order permitting comments on the Offer of Settlement and on certain questions included in the order, on or before August 29, 2002. That order also permitted VNG and Consumer Counsel to file responses to such comments and to the questions listed in the order on or before September 5, 2002.

On August 29, 2002, Staff filed comments on the Offer of Settlement and on the questions in the order ("Staff Comments"). Staff concludes, among other things, that the WNA may not be implemented as an experimental rate design pursuant

to § 56-234 of the Code because the WNA does not meet the statutory criteria delineated by the Commission. If the Commission finds that the WNA does meet the definition of an experiment under § 56-234, Staff states that notice of the Offer of Settlement and an opportunity for a hearing must be given. Staff also concludes that the Commission may approve an experiment under § 56-234 of the Code without an ore tenus hearing. Staff indicates, however, that it believes the complexity of the issues in this matter may be best developed for the Commission's consideration by an ore tenus hearing, and that the ramifications of increasing the authorized return on equity range and the potential impact of the WNA on customer bills need to be investigated further.

Staff states that it believes any WNA the Commission decides to adopt should contain the following aspects: (1) it should only partially mitigate weather risks; (2) it should exclude a base level of non-heating usage from its application; (3) it should be voluntary and contain an opt-out provision; and (4) VNG should be directed to disclose fully the nature of the WNA to its customers as a line-item charge on the customers' bills, and the bill format and the customer education program should be determined.

Comments on the Offer of Settlement also were filed on August 29, 2002, by John J. Reynolds. Mr. Reynolds previously

filed comments in this proceeding on June 12, 2002, and continues to oppose the WNA. Mr. Reynolds states, among other things, that the management of price and volume risks due to weather or any other factors clearly belongs with VNG under regulatory supervision of the Commission, that the WNA only provides relief to VNG for the potential mismanagement of weather risks at the expense of the ratepayer, that the WNA should not and need not be implemented as an experiment, that any such experiment should give customers the choice to opt-in, and that authorized return on equity should be lowered substantially as a result of the WNA.

On September 5, 2002, Consumer Counsel filed a response as provided by the August 15, 2002, Order. Consumer Counsel states, among other things, that the concessions by VNG and the resulting Offer of Settlement are consistent with the terms of the settlement in a Kansas proceeding noted by Consumer Counsel in its prior comments. Consumer Counsel explains that it supports the Offer of Settlement to which it is a party, and that it will leave to VNG the task of advocating further on behalf of the Company's application in response to the Commission's August 15, 2002, Order and the Staff Comments.

On September 5, 2002, VNG filed comments on the Commission's August 15, 2002, Order and the Staff Comments.

VNG asserts, among other things, that § 56-234 of the Code, regarding experimental rates, applies to the proposed WNA. The Company explains that the WNA meets the criterion of § 56-234, in that it is necessary in order to acquire information which is or may be in furtherance of the public interest. VNG also concludes that the notice previously issued in this proceeding satisfies the notice requirements of § 56-234, and that the Commission may approve an experiment under § 56-234 without an ore tenus hearing. The Company also states that, if it is a matter of any concern to the Commission, the increase to the top of the range for allowed return on common equity contained in the Offer of Settlement can be disregarded.

In addition, VNG states that implementing the WNA as an experiment provides the Commission with the discretion to make adjustments in the methodology, if necessary, to protect the public interest. The Company asserts that instituting the WNA as a temporary matter will set no precedent and will ensure that actual data can be accumulated and studied prior to further consideration of the merits of such riders. VNG represents that there is no such program in Virginia now, and notes that Staff agrees the WNA concept is worth additional evaluation. VNG concludes that there is a sufficient basis in the record for the Commission to find that it should evaluate

whether the WNA will reduce bill volatility, reduce customer complaints, and better allow the Company to concentrate its efforts on improving planning and performance, rather than managing cash flow problems.

On September 9, 2002, Staff filed a Motion to Accept Reply and a Reply ("Motion" and "Reply," respectively). The Motion states, among other things, that the Reply identifies and responds to the latest and further changes VNG has made to the WNA proposal and its Offer of Settlement, corrects the Company's misunderstanding of the positions taken in the Staff Comments, and clarifies the issues remaining between Staff and VNG.

On September 10, 2002, VNG filed a letter that, among other things, responds to portions of Staff's Reply and includes a WNA Rider showing the pertinent calculations of the WNA formula and explaining how such calculations will be carried out to produce a monthly bill for each customer subject to the WNA. VNG concludes that the Commission can decide this case based on the pleadings and record lawfully before it. The Company requested oral argument for September 11, 2002, or, in the alternative, requested that it be permitted to file a written response to the Reply on or before September 16, 2002.

NOW THE COMMISSION, upon consideration of the pleadings, the Offer of Settlement, and the applicable law, finds as follows. We approve the proposed WNA as a two-year experiment involving the use of special rates, consistent with the Offer of Settlement and as modified herein. In addition, we note that the WNA, as set forth in the Offer of Settlement, was also proffered by the Office of the Attorney General in its statutory role of representing the interests of consumers.[1] The support of the Offer of Settlement by the Office of the Attorney General's Division of Consumer Counsel, on behalf of consumers, should be given significant weight.

We find that the WNA may be approved under the provisions of § 56-234 of the Code, as proffered in the Offer of Settlement and as modified herein. Section 56-234 of the Code permits "other experiments involving the use of special rates, where such experiments have been approved by order of the Commission after notice and hearing and a finding that such experiments are necessary in order to acquire information which is or may be in furtherance of the public interest."

The notice previously issued in this proceeding satisfies the requirements of § 56-234 of the Code. For example, the published notice in this case explains that VNG requested approval of a WNA applicable to Schedule – 1 Residential Firm

[1] Va. Code § 2.2-517 B 1.

Gas Sales Service and Schedule – 2 General Firm Gas Sales Service, that the WNA would address changes in non-gas revenue associated with normal weather, that the WNA would adjust customers' non-gas rate, and that VNG states the WNA will result in both credits and surcharges to customers' bills. In addition, as asserted by both Staff and VNG, and consistent with Commission precedent, we find that § 56-234 does not require the Commission to conduct an ore tenus hearing prior to approving an experiment thereunder.

We find, under § 56-234 of the Code, that the proposed WNA is necessary to acquire information that may be in furtherance of the public interest. We direct VNG to file reports in this docket on or before July 1, 2003 and 2004, which address the following: (1) the impact of the WNA on bill volatility; (2) customer reaction to the WNA, including the number and substance of customer comments by month; (3) the impact of the WNA on the Company's cash flow; (4) any planning and performance benefits achieved by the Company as a result of the WNA, and how such benefits have impacted consumers; (5) the Company's earned rate of return on rate base and return on common equity both with and without revenues from the WNA; (6) the findings of an annual internal audit of the WNA factors for both the residential and general service classes to ensure tariff compliance and to determine

the accuracy of the factors; and (7) any other information requested by Staff relevant to the experiment. The information acquired from this experiment will not be limited to these enumerated items. The information acquired from this experiment also may be critical in subsequently evaluating similar proposals.

We decline to adopt the provision in the Offer of Settlement that increases the top of the Company's return on equity range to 11.8 percent. For the purposes of future AIFs, the return on equity range will be 10.0 percent to 11.4 percent, with 10.0 percent being used to determine the write-off of deferred expenses.[2]

The Offer of Settlement requires the Company to file a fully adjusted cost of service study and the schedules required for a general rate case if VNG requests to continue the WNA after the two-year experiment. In this regard, we recognize that a general rate case may be appropriate prior to extending the WNA. For example, in the Offer of Settlement VNG agrees that the WNA Rider reduces its weather-related risks. In addition, the Commission may decide to institute a general rate case or other appropriate proceeding, which evaluates all of the Company's costs and revenues, prior to

[2] This provision of the experiment approved herein is not a measure of the impact of the WNA on risk and return.

any continuation of the WNA. Further, our approval of the experiment herein in no manner restricts the Commission's authority to institute and conclude a general rate case or other proceeding, which may result in a rate decrease, during the two-year experiment.

Finally, we decline to grant the Motion filed by Staff on September 9, 2002, and will not consider Staff's Reply or the letter filed in response by VNG on September 10, 2002. We appreciate the participants' efforts to create a full record in this case. We conclude that these additional pleadings are not necessary for us to reach a decision in this matter.

Accordingly, IT IS HEREBY ORDERED THAT:

(1) VNG may implement an Experimental Weather Normalization Adjustment Rider as proposed in the Offer of Settlement submitted by the Company and the Office of the Attorney General's Division of Consumer Counsel, and as modified by this Order. This experiment involving the use of special rates shall terminate in two (2) years from the date of this Order.

(2) As provided for in the Offer of Settlement, the Company shall calculate separate weather adjustment factors for the residential and general service rate schedules based on a billing cycle calculation beginning with billing cycle

ten (10) in November 2002, for six billing cycles for each year of the experimental period.

(3) As provided for in the Offer of Settlement, the calculation of the WNA rate shall be as follows:
(a) determine total revenue by customer class to be recovered from or credited to each billing cycle by multiplying VNG's non-gas rate by the product of the number of customers to be billed, the use/degree day/customer, and the difference between the actual degree days and the weather normalized degree days; and (b) apportion the total revenue to each customer within that class by dividing the revenue determined in (3)(a) by the total actual class consumption within that billing cycle and applying the resulting rate to each customer's consumption.

(4) As provided for in the Offer of Settlement, the Company shall develop a bill format and consumer education program, in a form acceptable to the Commission Staff, that will afford customers an opportunity to understand the need for and the mechanics of the WNA Rider.

(5) The Company's return on common equity range, for purposes of future Annual Informational Filings, will be 10.0 percent to 11.4 percent, with 10.0 percent being used to determine the write-off of deferred expenses.

(6) As provided for in the Offer of Settlement, the Company shall not file a base rate case, or any non-gas revenue neutral rate design proposals applicable to residential and general service classes, before July 1, 2004, except under emergency conditions as set forth in § 56-245 of the Code of Virginia. This ordering paragraph in no manner precludes the Commission, on its own motion or upon proper pleading, from instituting a general rate case or other proceeding that may result in a rate decrease during the two-year experiment.

(7) As provided for in the Offer of Settlement, any request by the Company to extend the experiment approved herein or to make such rate permanent, shall be accompanied by a fully adjusted cost of service study and the schedules required for a general rate case.

(8) The Company shall file reports in this docket on or before July 1, 2003 and 2004, which address the following: (a) the impact of the WNA on bill volatility; (b) customer reaction to the WNA, including the number and substance of customer comments by month; (c) the impact of the WNA on the Company's cash flow; (d) any planning and performance benefits achieved by the Company as a result of the WNA, and how such benefits have impacted consumers; (e) the Company's earned rate of return on rate base and return on common equity both

with and without revenues from the WNA; (f) the findings of an annual internal audit of the WNA factors for both the residential and general service classes to ensure tariff compliance and to determine the accuracy of the factors; and (g) any other information requested by Staff relevant to the experiment.

(9) Within five days of the date of this Order, the Company shall contact the Commission Staff to develop the bill format, the consumer education program, and the reports as required herein.

(10) Within five days of the date of this Order, the Company shall file with the Commission's Director of the Division of Energy Regulation a tariff for the Experimental Weather Normalization Adjustment Rider approved herein.

(11) The Motion and Reply filed by Staff on September 9, 2002, and the letter filed in response by VNG on September 10, 2002, are hereby rejected.

(12) This matter is continued pending further orders of the Commission.

MOORE, Commissioner, Dissents:

The Weather Normalization Adjustment ("WNA") proposed by Virginia Natural Gas, Inc. ("VNG" or "Company"), cannot be legally approved by this Commission based on the record before us. Accordingly, I must respectfully dissent.

The law in Virginia is clear. Section 56-234 of the Code of Virginia states:

> It shall be the duty of every public utility to furnish reasonably adequate service and facilities at reasonable and just rates to any person, firm or corporation along its lines desiring same. It shall be their duty to charge uniformly therefor all persons, corporations or municipal corporations using such service under like conditions.

Section 56-235.2 of the Code provides:

> Any rate, toll, charge or schedule of any public utility operating in this Commonwealth shall be considered to be just and reasonable only if: (1) the public utility has demonstrated that such rates, tolls, charges or schedules in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility in serving customers within the jurisdiction of the Commission, subject to such normalization for nonrecurring costs and adjustments for known future increases in costs as the Commission may deem reasonable, and a fair return on the public utility's rate base used to serve those jurisdictional customers; (1a) the investor-owned public electric utility has demonstrated that no part of such rates, tolls, charges or schedules includes costs for advertisement, except for advertisements either required by law or rule or regulation, or for advertisements which solely promote the public interest, conservation or more efficient use of energy; and (2) the public utility has demonstrated that such rates, tolls, charges or schedules contain reasonable classifications of customers.

There are several exceptions to the statutory scheme set forth above. Section 56-40 provides one such exception. The provision states:

> The Commission, in the exercise of its discretion, may permit any public utility corporation to put into effect any proposed revision of its rate schedules, or any part thereof, without notice when the proposed revision effects no increases.

The Company's original Application was based on this section.[1] The Company stated that the WNA "does not increase the rates established by the Commission in the Company's most recent base rate case, Case No. PUE960227." The Application then explains how the WNA is an "adjustment" that would sometimes provide a "credit" and sometimes, when warmer than normal weather occurs, "customers will be surcharged."[2] The statute is specific; § 56-40 applies if the "revision of [the] rate schedules . . . effects no increases." As explained in the application, if the weather is warmer than usual, customers will be surcharged, which effects an increase. The fact that there might be a decrease in another month, or that these might balance out over time does not change the fact that the WNA revision is designed to effect an increase when weather is warmer than normal.[3]

If a ratepayer may be required to pay more under the new rate than he or she would have under the old rate, even for a single month, then § 56-40 does not apply. In such a circumstance we cannot conclude that the revision of the rate schedules "effects no increases." The majority was correct in not approving the WNA under § 56-40.[4]

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[1] April 16, 2002, Application at 1.

[2] *Id*.

[3] There was also the suggestion that the proposed rate revisions might pass muster under § 56-40 because the change would be revenue neutral or only recover the revenue requirement the Commission envisioned in its 1998 order. *Id*. at 1, 3. While revenue requirement is an important element in establishing rates, this Commission sets, and the utility charges, rates not revenue requirement. If the "rate schedules or any part thereof" effects an increase, then § 56-40 does not apply.

[4] Contrary to the Company's assertion, the applicability of § 56-40 was not mooted by the notice requirement imposed by the Commission in our Order of April 29, 2002. September 5, 2002, Comments of Virginia Natural Gas, Inc. on the Commission's Order of August 15, 2002, and Staff Comments Filed August 29, 2002, ("September 5, 2002, Comments") at 11-12. Had the WNA "effect[ed] no increase," the Commission could have "in the exercise of its discretion," approved the WNA.

Second, there are exceptions for "special rates, contracts or incentives to individual customers or classes of customers" and optional performance-based regulation, both subject to separate requirements.[5] The Company does not suggest that the WNA is presented under either exception.[6]

The Company does argue that the "experiment" exception of § 56-234 applies. This exception follows the requirements quoted above and states:

> However, no provision of law shall be deemed to preclude voluntary rate or rate design tests or experiments, or other experiments involving the use of special rates, where such experiments have been approved by order of the Commission after notice and hearing and a finding that such experiments are necessary in order to acquire information which is or may be in furtherance of the public interest.

The proposed WNA is not an experiment, and there has not been a showing that the proposal is necessary to acquire information which is or may be in furtherance of the public interest. In addition, notice was not given under that statute, and no hearing was held. The WNA cannot be approved as an experiment.

In its April 16, 2002, Application, the Company proposed a WNA that would apply without a time limit, and the proposal was not designated an "experiment." Section 56-234 was not mentioned.

Later, the Company and the Division of Consumer Counsel of the Office of the Attorney General ("Consumer Counsel") negotiated and agreed to support a modified WNA. Paragraph 7 of the Offer of Settlement[7] presented to the Commission stated:

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[5] §§ 56-235.2 and -235.6.

[6] Nor does the Company suggest other statutory provisions such as the temporary rate increase provisions of § 56-245 are applicable.

[7] Appendix A at 3 to the August 13, 2002, Response of Virginia Natural Gas, Inc. to Staff Report ("August 13, 2002, Comments").

> The Company agrees that the WNA Rider is an experimental rate design as defined in Virginia Code § 56-234, and further, that such rate design will terminate in two (2) years from the date of approval thereof subject to Commission action either extending or making such rate design permanent provided, however, any request by the Company for such extension or permanent rate must be accompanied by a fully adjusted cost of service study and the schedules required for a general rate case.

This is the first mention that the WNA might be an "experiment."

In its Comments supporting the Offer of Settlement, there is scant reference to the "information" we must find necessary "in furtherance of the public interest," required by § 56-234. The Comments state:

> Instituting the WNA . . . will ensure that actual data can be accumulated and studied prior to further consideration of the merits of such programs. . . . Valuable insight which would be applicable to other companies, as well, will be gathered during this time. [the two years of the "experiment"].[8]

Although there are more words on the information to be elicited during the "experiment" in the Company's response to our Order of August 15, 2002, there is no additional substance.[9] Typical of the references to the "information" to be acquired and the "experimental" nature of the proposal are those found in the conclusion at page 5:

> In short, this is what the experiment will determine, i.e., whether the Company can perform better and whether customers will benefit if their bills are weather normalized.[10]

[8] August 13, 2002, Comments at 3.

[9] September 5, 2002, Comments at 2, 4, 5, 7-8.

[10] September 5, 2002, Comments at 5.

Experiments are performed to answer questions or to test a hypothesis. Vague generalities do not suffice. Here, there is no description of any experiment nor any indication of what data, or even kinds of data, might be collected.

The majority recognizes the deficiencies of the Company's case with respect to the "information" that may be acquired through the so-called experiment. While the majority attempts to shore up VNG's position, my colleagues do little better than the Company. The majority justifies its position that the WNA is an "experiment" by requiring reports that address the following:

> (1) the impact of the WNA on bill volatility; (2) customer reaction to the WNA, including the number and substance of customer comments by month; (3) the impact of the WNA on the Company's cash flow; (4) any planning and performance benefits achieved by the Company as a result of the WNA, and how such benefits have impacted consumers; (5) the Company's earned rate of return on rate base and return on common equity both with and without revenues from the WNA; (6) the findings of an annual internal audit of the WNA factors for both the residential and general service classes to ensure tariff compliance and to determine the accuracy of the factors; and (7) any other information requested by Staff relevant to the experiment.

No experiment is required or warranted for items (1), (3), and (5). In fact, analysis of these items must be completed before the adjustment is allowed, not after. The Company can provide the data sought by these items by adjusting and pro forming prior years' data for actual weather and the WNA. Volatility, with and without the WNA, can be analyzed over a number of years under various weather conditions. The impact the WNA would have had on the Company's cash flow can be determined to the penny for any given period. The impact of the WNA on the Company's rate of return on rate base and return on common equity can likewise be determined with precision for many years. We could see the impacts over a long period of time, and we could be certain there would be years with colder than normal weather and years with warmer than normal weather. Most importantly, of

course, we would analyze this information before we act. The suggestion that we must have an experiment to obtain the data in items (1), (3), and (5) is simply incorrect.

Item (6), requiring an internal audit, may ensure the accuracy of bills, but it will not address the fact that the automatic increases are not tied to costs and may not be just and reasonable. The remaining two items, (2) and (4), are nothing more than form over substance. This Commission should not ask, after the WNA is approved, as majority does in item (4), for the Company to advise the Commission of "any planning and performance benefits achieved by the Company as a result of the WNA, and how such benefits have impacted consumers." The Company should have explained the "benefits" in the Application, including their expected value. Then, these benefits could have been examined as part of this proceeding. Also, it is interesting that the Company is not required to report any detrimental effects over the two-year period. Finally, with respect to item (2), we should not ask for customer reaction to a tariff proposal until we are satisfied the rates are just and reasonable.

In addition, the Company states that experiments need not be voluntary[11] and concludes that we can mandate an experiment for customers that would charge rates (without opportunity for refund) that may be unjust, unreasonable, and discriminatory. While we need not answer this question here because the proposal is not an experiment under § 56-234, the Company's contention is questionable at best and was presented without citation to any authority.

The lack of proper notice and hearing must also be noted. Section 56-234 requires "notice and hearing." The majority concludes that since the original notice describes a version of the WNA, including credits and surcharges, additional notice is unnecessary. VNG argues that notice of the

[11] September 5, 2002, Comments at 6.

change has been given and since the experiment "is a lesser remedy than what was proposed in the notice," nothing further is required.[12] Both miss the point. Experiments under § 56-234 require separate notice. Nothing in any statute or rule suggests otherwise. Contrary to VNG's contention, the remedy now requested is greater than originally sought because the relief requested is an exception to the requirements that rates be just, reasonable, and nondiscriminatory. When a monopoly utility proposes an experiment involving rates that may be unjust, unreasonable, and discriminatory that will be applied for two years without opportunity for a refund, notice of that fact is required. In a normal rate proceeding, the law requires, and the public may presume, that the rates ultimately approved will, in the Commission's view, be just, reasonable, and nondiscriminatory. The fact that this is an experiment where the statutory requirements of just, reasonable, and nondiscriminatory rates will not apply is a critical part of the notice. This is particularly applicable here because the Company has presented no data indicating that the proposed change meets the requirements of just and reasonable rates under § 56-235.2 of the Code of Virginia.

Finally, with respect to § 56-234, no hearing was held. Section 56-234 does not say an "opportunity for a hearing"; it says a hearing. A hearing means a hearing, not a consideration of pleadings only, particularly where there are so many issues in controversy and the application is subject to such serious question. For example, for several years we held ore tenus "hearings" before issuing certificates for competitive local exchange carriers under § 56-265.4:4 until the section was amended to require only "an opportunity for hearing."[13] The hearings were formalities, without opposition or

[12] September 5, 2002, Comments at 8-9 (emphasis in original).

[13] 2001 Va. Acts, ch. 75.

significant questions, but we complied with the law. Here, where much is questionable, we should do no less.

The WNA was not an experiment when it was filed and is not one now. While the substance of the WNA presented in the "settlement" is different in certain respects from the original proposal, there is no suggestion that any change other than the two-year limit makes the current WNA an experiment under § 56-234. Including a sunset clause in a proposed rate change that can increase rates without the possibility of a refund does not make the proposal an experiment.

The precedent of this case is far reaching and devastating to critical protections provided by §§ 56-234 and -235.2. From now on, a utility may obtain a rate increase without proof that its proposed rates are just and reasonable. It will be difficult to distinguish other requests from this one as long as there is a time limit on the proposed change.

Without an exception, the Company and this Commission are bound by, among others, §§ 56-235.2, -238, and -240 of the Code of Virginia. These statutes require the utility to charge just and reasonable rates as defined by § 56-235.2. Before rates may be changed, they must be filed with the Commission and notice given. The Commission may, under § 56-238, suspend the proposed rates for up to 150 days during which time we are to investigate the reasonableness or justness of the rates. After 150 days, the rates may become effective, but are subject to refund until a final order is issued by the Commission. Under § 56-240, we may allow the rates to become effective without suspension. To do so, a public utility must have filed:

> information and data designed to show that any increase complies with the just and reasonable requirements of § 56-235.2, and . . . based thereon the Commission finds a reasonable probability that the increase will be justified upon full investigation and hearing.

In this case, the Company has provided no information to determine whether the proposed rates comply with the requirements of § 56-235.2. The rates are not subject to refund and will not even be examined for two years. At that time, changes will be prospective only. In sum, customers may be overcharged and there will be no remedy. The Company and, presumably, the majority and Consumer Counsel are not concerned. In its order, the majority does not even state that a general rate proceeding will be required before the "experiment" may be continued, rather "a general rate case may be appropriate prior to extending the WNA" (emphasis added).

Failing to require cost and revenue data as part of a general rate proceeding before approving the WNA is particularly egregious in this case. First, under § 56-235.2, the public utility must "demonstrate" that its rates "in the aggregate" do not provide revenues in excess of "the aggregate actual costs . . . [of] serving customers." The WNA looks at a single element of a utility's rates and adjusts revenues only, without any analysis of the costs. Under § 56-235.2, rate changes are to be made only after the applicant has shown that aggregate revenues do not exceed aggregate costs. Just two years ago, we made this very point explicit in adopting amendments to our rate case rules:

> We find that § 56-235.2 requires that when any rate, toll, charge, or schedule is to be increased in a proceeding, the public utility must demonstrate at that time that its rates, tolls, charges, or schedules in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the utility in serving its jurisdictional customers. (emphasis in original).[14]

Here, there is no evidence related to either aggregate revenues or aggregate costs.

[14] *Commonwealth of Virginia, At the relationship of the State Corporation Commission, Ex Parte: In the Matter of Adopting Additions and Amendments to the Commission's Rules Governing the Filing of Utility Rate Increase Applications*, Case No. PUA-1999-00054, 2000 S.C.C. Ann. Rept. 140, 141.

Also, a critical element of § 56-235.2 is that costs and revenues are examined together; revenues are not adjusted absent an analysis of costs. Yet, the WNA will do precisely that, adjust revenues without any review of changes in costs.

In light of § 56-235.2, this Commission has been hesitant to establish automatic clauses. The Commission's opinion in *Application of Old Dominion Power Company, Inc*. sets forth basic criteria for automatic clauses. Essentially we concluded that in order to allow an automatic clause, the adjustment must be in response to costs that are volatile, major, continuous, and beyond the control of the company.[15]

Of perhaps more relevance to this proceeding is our decision in *Application of Roanoke Gas Company.*[16] In that case we went beyond the criteria set forth in *Old Dominion Power* and allowed a Distribution System Renewal Surcharge (DSR Surcharge) to permit Roanoke Gas to recover the depreciation and carrying costs on all prudently incurred system renewal costs up to a maximum of $1.5 million each year without the requirement to file a rate case. The return on equity, for earnings test purposes, was reduced .25%. In addition, procedures were established to ensure that the recovery allowed through the clause tracked the actual dollars expended. Finally, although presented as an "experiment" under § 56-234 by the Hearing Examiner, we approved the program for three years, but stated specifically that "[w]e do not find the DSR Surcharge proposal to be an experiment under § 56-234 of the Code of Virginia."[17]

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[15] *Application of Old Dominion Power Company, Inc., For an increase in rates*, Case No. PUE-1983-00035, 1984 S.C.C. Ann. Rept. 408, 409.

[16] *Application of Roanoke Gas Company, For general increase in rates and to revise its tariff*, Case No. PUE-1998-00626, 1999 S.C.C. Ann. Rept. 440, 442.

[17] *Id*. 1999 S.C.C. Ann. Rept. at 442, n.9.

These cases are instructive. First, both proposed "adjustment clauses" were presented in the context of a general rate case where § 56-235.2 applied, and data showing aggregate costs and aggregate expenses were presented. Second, both cases presented clauses that were tied to actual costs that had been expended. Further, in *Roanoke Gas*, where the clause was approved, we required procedures to ensure that the automatic clause was based on actual current costs for the renewal program.

This case is strikingly different. First, there is no rate case to examine aggregate costs and aggregate revenues. Second, the proposed clause is not based on costs, but rather "revenues" that are, at best, more than six years removed from any cost study. Further, there is no procedure to ensure that the revenues are tied to actual costs.

In addition to these conflicts with § 56-235.2 and our holdings on automatic clauses, the Company's current rates were set based on a test year ending June 30, 1996, more than six years ago. Since then, this Company has been transferred two times, most recently to AGL Resources, Inc. There has been corporate restructuring. The industry itself has changed. Each of these impacts this Company and its costs. None has been considered in this proceeding.

In the 1996 rate case involving data that are more than six years old, costs were established and allocated among classes. These costs then became rates based on normal weather, number of customers, and loads. The proposal seeks to recover the same weather-normalized non-gas revenue as authorized in the Company's 1996 rate case adjusted for customer growth. The proposal is <u>not</u> like a fuel factor or a purchase gas adjustment clause. It is <u>not</u> a flow through of costs. Rather, it is an adjustment to ensure recovery of revenues regardless of their relationship to costs.

A complete review of all costs and revenues must be required before the WNA is considered. For example, certainly the costs have changed. We do not know whether the current rate per ccf recovers those costs. They may under-recover or over-recover VNG's costs. The Company, like most, has implemented cost saving measures including reducing personnel. It has reorganized under a new owner that may have brought new efficiencies to its system. We do not know whether these changes have reduced costs to offset, at least in part, the impact of warmer than normal weather. We do not know what the cost of capital, particularly the cost of equity, is. For example, the current cost of capital, including the cost of equity, was established when VNG was a subsidiary of Consolidated Natural Gas, and VNG's cost of capital was based on CNG's rate making capital structure.[18] In addition, VNG's customer base may have grown which could reduce certain average costs. The characteristics of the various customer classes have probably changed, altering the allocations among these classes in a way that could impact rates regardless of changes in total costs. The "normal" weather used to establish rates in the last case has changed and should be updated. These are merely some of the issues that must be addressed before any rate change that could increase rates is considered.

With respect to the WNA itself, additional analysis is required before it should be considered, even as part of an over-all rate review. In addition to the forgoing, issues are raised such as whether non-heating customers whose usage may not be weather sensitive should be subject to adjustment. Also, the WNA appears to assume that there is no correlation between cost and weather, that costs do not decrease at all with warmer than normal weather. That assumption could be tested without putting

[18] *Application of Virginia Natural Gas, Inc., For an expedited increase in gas rates*, Case No. PUE-1996-00227, 1998 S.C.C. Ann. Rept. 338, 339-340.

customers at risk by analyzing data from prior years and evaluating the correlation between weather and cost, if any. We need to know whether an automatic adjustment such as the one proposed reduces the cost of equity and, if so, by how much. We need to analyze alternatives to the WNA, including stabilizing rate design proposals, weather insurance, or revising the definition of normal weather to reflect a shorter period over which normal weather is measured.

Finally, the majority gives "significant weight" to the fact that Consumer Counsel agreed to the proposed settlement. I agree that such weight should be given. Support by Consumer Counsel, however, cannot and does not change the law. The proposal is not an experiment, and there has been no showing that the WNA meets the requirements of § 56-235.2. There is no mechanism to track the relationship between the WNA and any costs because the WNA is not tied to costs. The costs can decrease, while the revenues increase. An extraordinary showing should be required before such an adjustment is approved. Here there has been no showing and no hearing.

The law, sound regulation, and common sense require that the WNA be considered only as part of a general rate review.